NATIONAL ASSOCIATION
OF REALTORS®

The Voice for Real Estate®

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SUMMARY OF

WRITTEN STATEMENT OF THE

NATIONAL ASSOCIATION OF REALTORS®

BEFORE THE

FEDERAL DEPOSIT INSURANCE CORPORATION

HEARING ON THE DEPOSIT INSURANCE APPLICATION OF WAL-MART BANK

APRIL 11, 2006

NATIONAL ASSOCIATION OF REALTORS®

NAR believes that Wal-Mart's effort to obtain a federally-insured depository institution, if successful, will establish a dangerous precedent leading inevitably to an erosion of the national policy against mixing of banking and commerce and have serious consequences for the continued stability and growth of the nation's financial system.

Mixing Banking and Commerce Creates Conflicts of Interest and an Unlevel Playing Field

Banks must be "honest brokers" of financial services and not be swayed into making credit and other business decisions based on their affiliation with commercial firms. But when commercial firms are allowed to engage in banking, the bank functions under an inherent and irreconcilable conflict of interest.

Federally insured depository institutions have access to cheap capital and funding because of federal deposit insurance. In addition, banks are the only entities that have access to the Federal Reserve's discount window and payment system. The availability of Federal deposit insurance, access to the payments system, and the Fed's discount window are advantages available only to banking institutions. Permitting Wal-Mart to affiliate with an insured bank will enable it to benefit indirectly from the federal subsidy enjoyed exclusively by banks and will enable Wal-Mart to compete on an unlevel playing field with other commercial firms.

If the Wal-Mart Bank were to expand its business plan into retail banking, it is reasonable to expect that it would use the enormous financial resources of its parent, Wal-Mart Stores, to seek to become the dominant, or even sole, player in banking in its rural markets. If Wal-Mart Bank becomes the main or only provider of financial services in a market, it would place commercial competitors at a serious disadvantage in seeking financial services.

Risk to the Stability of the Financial System

Federal Reserve Board Chairman Ben Bernanke has recently reaffirmed statements made by former Federal Reserve Chairman Alan Greenspan and other Federal Reserve Board Governors raising concerns about the industrial loan company loophole. NAR believes that these statement support NAR's recommendation that the FDIC should not approve the Wal-Mart application until Congress has an opportunity to consider the appropriateness of existing law and vote on whether to sunset existing authority, as it did in 1999 when the Gramm-Leach-Bliley Act slammed the door on commercial firms acquiring thrifts.

One of the most important risks raised by the application is that providing Wal-Mart with direct access to the payments system would enable Wal-Mart to spread the risk of the company's commercial operations to other participants in the payment system. Today, banks serve as trusted intermediaries when making or collecting payments on

behalf of customers. The process breaks down, however, when the merchant's bank is a captive of the merchant, for the bank cannot exercise independent credit judgment. Wal-Mart Bank's failure to exercise independent credit judgment will mean that Wal-Mart's credit risk will be transferred to the payment system from the banks with which it now does business and that apply controls on the amount of payments they process for Wal-Mart. As a result, banks participating in the payment system will be forced to absorb the risk of a default by Wal-Mart Stores. If this were to happen, by the time the true condition of the enterprise became known, it could very well be too late to save the Bank or minimize harm to the rest of the financial system.

Section 6 requires the FDIC Board to consider the risk to the deposit insurance fund (12 U.S.C. § 1816(5)). The risks to the insurance fund that I have outlined provide, by themselves, an ample basis for an FDIC decision to disapprove the application.

Absence of Community Benefit

Section 6 of the Federal Deposit Insurance Act also requires the FDIC Board, in considering an application for deposit insurance, to consider the convenience and needs of the community to be served by the bank (12 U.S.C. § 1816(6)). The bank will contract out almost all its functions and projects meager earnings of approximately $13.5 million over three years, suggesting Wal-Mart Bank will generate almost no significant savings, considering its enormous income. NAR sees virtually no benefit to the community resulting from approval of the Wal-Mart Bank application.

Other Initiatives to Permit Banks into Commerce Should Also Be Blocked

While the banking industry generally opposes the Wal-Mart application, it is simultaneously seeking to expand permissible bank activities into real estate brokerage, management, and real estate development—essentially commercial activities. NAR believes that the various government agencies involved should reverse any trend in this direction. In 2001, for example, the Federal Reserve Board and the Treasury Department published a proposed rule that would permit financial holding companies and financial subsidiaries of national banks to engage in real estate management and brokerage. More recently, the Office of the Comptroller of the Currency (OCC) has issued several rulings that, in our view, go beyond the statutory authority banks have to own real estate to accommodate their businesses. We think that permitting banks to develop and own luxury hotels and develop residential condominiums for immediate sale in order to make the remainder of a project economically feasible stretches the law to the breaking point.

Conclusion

Accordingly, the National Association of REALTORS® urges the FDIC not to approve the Wal-Mart Bank deposit insurance application because it does not meet the statutory standards for approval and because the issue is of such significance that Congress should decide whether it is appropriate to permit the mixing of banking and commerce under these circumstances.

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HEARING ON THE DEPOSIT INSURANCE APPLICATION OF WAL-MART BANK

APRIL 11, 2006

On behalf of more than 1.2 million members of the National Association of REALTORS® (NAR), I am pleased to submit our views to the Federal Deposit Insurance Corporation (FDIC) on the pending application filed by Wal-Mart Stores, Inc. for federal deposit insurance for Wal-Mart Bank, a proposed Utah-chartered industrial bank (commonly referred to as an industrial loan company or ILC).

The National Association of REALTORS®, "The Voice for Real Estate," is America's largest trade association, including NAR's five commercial real estate affiliates. REALTORS® are involved in all aspects of the residential and commercial real estate industries and belong to one or more of some 1,500 local associations or boards, and 54 state and territory associations of REALTORS®.

NAR is concerned about Wal-Mart's pending federal deposit insurance application. The application marks the latest chapter in Wal-Mart's continuing effort to gain a foothold entry into the banking industry. We believe that Wal-Mart's effort to obtain a federally-insured depository institution, if successful, will establish a dangerous precedent that will inevitably lead to an erosion of the national policy against mixing of banking and commerce and have serious consequences for the continued stability and growth of the nation's financial system. NAR urges you to carefully consider the risks of permitting Wal-Mart to control an insured bank, even one whose powers are, at least initially, purported to be limited.

Wal-Mart has publicly stated that the company's sole motivation is to have the Bank act as a vehicle for providing Wal-Mart with direct access to the payment system to process electronic payments such as debit and credit card and Automated Clearing House (ACH) transactions. However, the publicly available portions of Wal-Mart's FDIC application expressly provide that "the Bank will also offer certificates of deposit." The statement is unqualified. As best as we can determine, Wal-Mart proposes no limitation in the application that precludes Wal-Mart from significantly expanding the bank's

deposit taking activities at any time. Some of the significant risks raised in this testimony will undoubtedly come to fruition if a Wal-Mart Bank is able to compete with other depository institutions in accepting deposits. These risks would be exacerbated if the Bank were to engage at some future time in lending activities. Moreover, we do not believe that requiring the bank to obtain the FDIC's approval before expanding its activities or inviting public comment if the bank seeks to expand its activities will adequately protect the public interest.

The following is a discussion of the key reasons why we object to approval of the Wal-Mart application.

Mixing Banking and Commerce Creates Conflicts of Interest and an Unlevel Playing Field

Banks must be "honest brokers" of financial services and not be swayed into making credit and other business decisions based on their affiliation with commercial firms. This is one of the key reasons banks are not permitted to engage in commercial activities. And when commercial firms are allowed to engage in banking, the bank also functions under an inherent and irreconcilable conflict of interest. While there are existing restrictions on transactions between a bank and its affiliates, we think that the bank's commercial parent will inevitably use the bank to further the corporate objectives of the company, which may be at odds with what is in the best interests of the bank subsidiary, customers, competitors, and our financial system. If the parent is in the midst of a financial crisis, ethical and legal behavior by senior management cannot always be assumed**.** No company is immune from improper actions of its employees. Indeed, even Wal-Mart has been victimized by fraudulent actions of its dishonest Vice Chairman.[1] We cannot afford to open the door to actions that threaten the safety and soundness of the banking system.

[1] See **http://walmart.nwanews.com/wm_story.php?paper=adg&storyid=144830**

Federally insured depository institutions have access to cheap capital and funding because of federal deposit insurance. In addition, banks are the only entities that have direct access to the Federal Reserve's discount window and payment system. The availability of Federal deposit insurance, access to the payments system, and the Fed's discount window are advantages available only to banking institutions. Permitting Wal-Mart to affiliate with an insured bank will enable it to benefit indirectly from the federal safety net enjoyed exclusively by banks and will enable Wal-Mart to compete on an unlevel playing field with other commercial firms.

If the Wal-Mart Bank were to expand its business plan into retail banking, it is reasonable to expect that it would use the enormous financial resources of its parent, Wal-Mart Stores, to seek to become the dominant, or even sole, player in banking in its rural markets. That is precisely what has already happened in many small retail markets around the country. If Wal-Mart Bank becomes the main or only provider of financial services in a market, it would place commercial competitors at a serious disadvantage in seeking financial services. The bank would have a strong incentive to base its credit decisions on whether the applicant competes with the bank's parent. Moreover, with regard to retail customers, the bank would have an incentive to ensure that credit is amply available to customers who shop at Wal-Mart rather than at local competitors. This is uniquely significant in the case of Wal-Mart considering that the opening of a Wal-Mart store has been the death knell of the small businesses in many small towns.

Risk to the Stability of the Financial System

Federal Reserve Board Chairman Ben Bernanke has recently reaffirmed statements made by former Federal Reserve Chairman Alan Greenspan and other Federal Reserve Board Governors raising concerns about the industrial loan company loophole. This loophole is the last significant exception that permits a commercial firm to control a federally insured bank that is broadly engaged in lending and deposit taking activities. In a written statement provided in response to a question asked by Representative Brad Sherman at the February 15th House Financial Services Committee hearing, Chairman

Bernanke explained that Congress should decide the extent to which mixing of banking and commerce should be permitted, if at all. He noted that—

> the Board has encouraged Congress to review the exemption in current law that allows a commercial firm to acquire an FDIC-insured industrial bank (ILC) chartered in certain states without regard to the limits Congress has established to maintain the separation of banking and commerce. Continued exploitation of the ILC exception threatens to remove this important policy decision from the hands of Congress.

We believe Chairman Bernanke's statement supports NAR's recommendation that the FDIC should not approve the Wal-Mart application until Congress has an opportunity to consider the appropriateness of existing law and vote on whether to sunset existing authority, as it did in 1999 when the Gramm-Leach-Bliley Act slammed the door on commercial firms acquiring thrifts.

A recent report of the U.S. Government Accountability Office questions the risk to the Bank Insurance Fund presented by nonfinancial companies of insured industrial loan companies.[2] The GAO concluded that although the FDIC has supervisory authority over an insured ILC, it has less extensive authority to supervise ILC holding companies than the consolidated supervisors of bank and thrift holding companies. Therefore, according to the GAO, from a regulatory standpoint, ILCs controlled by commercial companies and supervised by the FDIC may pose more risk of loss to the bank insurance fund than other insured depository institutions operating in a holding company. Restructuring the supervisory framework for ILCs along the lines of the Federal Reserve Board's comprehensive umbrella supervisory authority over bank holding companies is not the solution because it will simply leave the door open to a continued mixing of

[2] "Industrial Loan Corporations: Recent Asset Growth and Commercial Interest Highlight Differences in Regulatory Authority," GAO-05-621 (September 2005), www.gao.gov/cgi-bin/getrpt?GAO-05-621.

banking and commerce. Because of the overriding policy reasons not to permit mixing banking and commerce, the solution is to close the ILC loophole once and for all.

One of the most important risks raised by the application is that providing Wal-Mart with direct access to the payments system would enable Wal-Mart to spread the risk of the company's commercial operations to other participants in the payment system. Today, banks serve as trusted intermediaries when making or collecting payments on behalf of customers. Banks typically will require corporate customers to meet certain credit standards before the bank will agree to act as the customers' "window" to the payment system. In effect, the bank guarantees to other banks participating in the payments system that it will make good on obligations arising from payments the bank makes on behalf of its customers. For example, if a bank originates an ACH debit on behalf of a merchant, the bank guarantees the receiving bank that it will reimburse the receiving bank if the ACH debit was not authorized by the receiving bank's customer. This "guarantee" is backed up by a thorough, independent credit review of the merchant's credit.

The process breaks down, however, when the merchant's bank is a captive of the merchant, for the bank cannot exercise independent credit judgment. It must do what its parent, in this case, Wal-Mart, tells it to do. There is nothing that can prevent Wal-Mart from compelling its bank to initiate wire transfers or ACH debits and credits and transferring risk of loss to the banking system. Given its limited resources (capital of merely $25 million after three years), Wal-Mart Bank's failure to exercise independent credit judgment will mean that Wal-Mart's credit risk will be transferred to the payment system from the banks with which it now does business and that apply controls on the amount of payments they process for Wal-Mart. As a result, banks participating in the payment system will be forced to absorb the risk of a default by Wal-Mart Stores. Such an involuntary transfer of credit risk is unacceptable and is another negative aspect of the Wal-Mart application.

If the Wal-Mart Stores parent of a Wal-Mart Bank were ever to find itself under financial pressure, it would be tempting for it to abuse its bank in a manner that enables it to resolve the problem. As we know from the collapse of Enron, WorldCom, and others in the last few years, circumstances sometimes spin out of the control of management and not all of those involved act within the law. If Enron or WorldCom had owned and abused its relationship with a federally insured depository institution, the impact on our economy would have been far worse. It is not reasonable to assume that if Wal-Mart found itself in a crisis, it would be entirely forthcoming about what is happening in communicating with its shareholders, the SEC, the FDIC or Federal Reserve Board, the Utah bank supervisor, or any other regulator. By the time these parties learned of the true condition of the enterprise, it could very well be too late to save the Bank or minimize harm to the rest of the financial system.

Section 6 requires the FDIC Board to consider the risk to the deposit insurance fund (12 U.S.C. § 1816(5)). The risks to the insurance fund that I have outlined provide, by themselves, an ample basis for an FDIC decision to disapprove the application.

Absence of Community Benefit

Section 6 of the Federal Deposit Insurance Act also requires the FDIC Board, in considering an application for deposit insurance, to consider the convenience and needs of the community to be served by the bank (12 U.S.C. § 1816(6)). We see virtually no benefit to the community resulting from approval of the Wal-Mart Bank application.

The Wal-Mart Bank will employ only five employees and occupy an office of only 1900 square feet. All functions of the bank will be outsourced to third party vendors, including such basic functions as general ledger and accounting system management. Despite statements that the primary purpose of the bank is to provide access to electronic payment systems to Wal-Mart Stores, the bank will be using correspondent banks to process electronically converted checks and to clear debit and credit card transactions, just as Wal-Mart is doing today. In effect, the bank will perform

virtually no operations for itself nor will it employ any significant number of personnel. Moreover, based upon the limited financial information available to the public from the application, it appears that in the first three years of operation, the bank is expected to generate meager earnings totaling approximately $13.5 million. This is a rounding error for Wal-Mart, whose net income for the year ending January 31, 2006, was over $11 billion. If Wal-Mart's purpose for establishing the bank is to reduce its expenses associated with its credit and debit card and ACH transactions, it appears that it will fail miserably. Because section 23B of the Federal Reserve Act requires insured banks to provide services to affiliates on market terms and conditions, presumably the reason for Wal-Mart Bank's projected meager earnings is not due to the bank charging Wal-Mart below-market fees for payments services. Based upon the fact that the bank will essentially be a shell operation, will employ no meaningful number of people, will perform no significant functions for itself, and will generate an insignificant amount of earning for Wal-Mart, we do not see how it serves the convenience and needs of the community to be served.

Other Initiatives to Permit Banks into Commerce Should Also Be Blocked

At the same time that numerous banking organizations and bank trade associations are strenuously opposing the Wal-Mart application on the basis that permitting commercial firms to own banks will result in an impermissible mixing of banking and commerce, they are themselves seeking to expand permissible bank activities into real estate brokerage, management, and real estate development—activities which by their very nature are commercial. NAR believes that the various government agencies involved should reverse any trend in this direction.

In 2001, for example, the Federal Reserve Board and the Department of the Treasury published a proposed rule that would permit financial holding companies and financial subsidiaries of national banks to engage in real estate management and brokerage. NAR believes that these activities are commercial, and apparently Congress agrees, since it has blocked the agencies from issuing a final rule. More recently, the

Office of the Comptroller of the Currency (OCC) has issued several rulings that, in our view, go beyond the statutory authority banks have to own real estate to accommodate their businesses. We think that permitting banks to develop and own luxury hotels and develop residential condominiums for immediate sale in order to make the remainder of a project economically feasible stretches the law to the breaking point. As in the case of the Wal-Mart deposit insurance application, we believe that Congress should resolve the irreconcilable clash of commercial and banking industries over these related issues, not regulatory agencies.

Conclusion

Accordingly, the National Association of REALTORS® urges the FDIC not to approve the Wal-Mart Bank deposit insurance application because it does not meet the statutory standards for approval and because the issue is of such significance that Congress should decide whether it is appropriate to permit the mixing of banking and commerce under these circumstances.